APPENDIX

United States Court of Appeals
for the District of Columbia Circuit

No. 19,796

Public Service Commission of the State of New York, *Petitioner,*

v.

Federal Power Commission, *Respondent*

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On Petitions to Review Orders of the Federal Power Commission

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Decided February 7, 1967

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Before Bazelon, *Chief Judge,* Wilbur K. Miller, *Senior Circuit Judge,* and Tamm, *Circuit Judge.*

Bazelon, *Chief Judge:*

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II

The In-Line Price

The second major dispute in this case concerns the FPC's determination of the in-line price. Since the CATCO decision, the FPC has been granting permanent certificates of public convenience and necessity only if the price of the gas is in-line. The question is, in line with what? Judging from these and other FPC proceedings, the "line" is determined as follows: First the Commission chooses a time

period and a geographical area which it considers relevant[35] and lists all the prices at which gas was sold at that time and in that area. Then it eliminates prices which are "suspect" either because they are presently under litigation or Commission review or because they are similar to a price under a cloud.[36] When the price array is completed the FPC makes several calculations, for example, the average price, the median price, the weighted average price, and the price at which substantial volumes of gas flowed in interstate commerce. The FPC adjusts some of these prices by assigning differing weights to the various prices which form the price array. At least one Commissioner in our case gave some weight also to a guideline price announced first in 1960 and subsequently revised.[37] The Commission considers these weights and the adjustments, and then picks a price.[38] Here the Commission set the in-line price at 15¢ per Mcf for District No. 2 during the period before the Policy Statement (September 28, 1960) and at 16¢ for the post-Policy Statement period.[39] For District No. 3, the prices were 16¢ and 17¢ respectively.

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[35] Here the area for the *Hawkins* proceeding was Texas Railroad District No. 3, and the area for the *Sinclair* proceeding was Texas Railroad District No. 2. In both proceedings there were two relevant time periods—in *Hawkins* from January 1, 1958, to September 28, 1960, (pre-Policy Statement period), and from September 28, 1960, to January 1, 1964, (post-Policy Statement period), and in *Sinclair* from January 1, 1957, to September 28, 1960, (pre-Policy Statement period), and from September 28, 1960, to March 10, 1964, (post-Policy Statement period).

[36] See, *e.g., United Gas Improvement Co.* v. *Federal Power Commission*, 283 F.2d 817 (9th Cir. 1960), *cert. denied sub nom. Superior Oil Co.* v. *United Gas Improvement Co.*, 365 U.S. 879 (1961).

[37] See Commissioner Bagge's concurring opinion in *Hawkins*. H.A. 297.

[38] The proceedings in this case provide some examples of the Commission's methods. See the appendix attached to this opinion.

[39] The pre- and post-Policy Statement periods are described fully in note 35 *supra*.

The petitioners have many disagreements with what the FPC did in this case. Continental and Superior think the Commission should have given more weight to certain 20¢ sales which were permanently certificated, to sales which were temporarily certificated, and to contract prices even before these prices are tested in any kind of certificate proceeding.[40] They also claim that the Commission erroneously considered certain sales at 14¢ and less, erroneously excluded intrastate sales, and erroneously used estimated rather than actual volumes when calculating weighted average prices. In short, they claim that the Commission acted arbitrarily and without any recognizable standards.

New York claims that the FPC should have given no weight to contract prices or to sales made pursuant to temporary certificates, and that it erroneously considered certain permanently certificated prices. New York says these permanently certificated prices were incorrectly determined and therefore should not be allowed to affect subsquent in-line prices.

To properly weigh these claims we must understand the purpose of in-line pricing.

In-Line Pricing

The concept of an in-line price is an artificial one created by the Supreme Court, the Courts of Appeals, and the Commission for the sole purpose of protecting the consumer. Before the concept existed, the FPC usually proceeded in the following way. A producer who wanted to sell gas in interstate commerce applied to the Commission for a certificate of public convenience and necessity under § 7 of the Act. When the certificate was granted, the producer-seller and the pipeline-buyer executed the sale at a

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[40] Their claim that the Commission disregarded these prices cannot be based on the record in this case. See, *e.g.,* S.A. 226 and H.A. 285-86 quoted in the appendix *infra.* The producers' claim is reduced to the contention that not enough weight was given.

price which they had already negotiated. If that price was too high, the FPC, either on its own motion or acting on the complaint of an interested party, could institute proceedings under § 5 of the Act to determine the "just and reasonable" price, after which the producer was forced to lower his price accordingly. However, since § 5 does not provide for refunds, the producer was allowed a "windfall" (with a consequent "squall" for the consumer) during the period between commencement of the sales and the conclusion of the hearing under § 5.[41] Section 5 hearings were long and complicated, and the windfall could be quite large. The ordinary protections of the market place did not exist in this regulated monopoly industry. The producer, of course, was interested in extracting the highest price from the buyer. But the buyer did not have an equal interest in keeping the price down because the price he paid became part of his rate base and was ultimately paid by the consumer.[42] Presumably the consumer did not have any choice except to buy the fuel at the price which was set.[43]

The procedure after the invention of in-line pricing changed in one significant way. Now, when the FPC grants a certificate of public convenience and necessity, a price condition is usually attached. A dissatisfied producer who wants to sell at a higher price can file a new rate schedule under § 4 of the Act subject to his contract with the pipeline.[44] These rates become effective after thirty days unless challenged by the FPC. Even if challenged, the new rates

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[41] *Atlantic Refining Co.* v. *Federal Power Commission, supra* note 6, at 390.

[42] *Atlantic Refining Company* v. *Federal Power Commission*, 115 U.S. App. D.C. 26, 28 at n. 11, 316 F.2d 677, 679 at n. 11, (1963).

[43] *United Gas Improvement Co.* v. *Federal Power Commission*, 290 F.2d 133, 135 (5th Cir.), *cert. denied sub nom. Sun Oil Co.* v. *United Gas Improvement Co.*, 368 U.S. 823 (1961).

[44] *Cf. Texaco* v. *Federal Power Commission*, 290 F.2d 149, 156 (5th Cir. 1961).

become effective after five months if the Commission has not completed its "just and reasonable" determination by that time. Eventually, then, the producer may charge whatever price he wants.[45] However, by filing under § 4, the producer becomes subject to payment of refunds if the FPC later finds that the price charged was not just and reasonable. In this way, the consumer is afforded at least some protection against excessive prices.[46]

The Use of Contract Prices

From the description of in-line pricing it is evident that the FPC cannot use the prices at which producers and pipelines contract as a basis for setting the price. The need for the FPC, and for a concept like in-line prices, arises primarily because the unregulated market place cannot protect the consumer adequately. Congress created the FPC to protect the consumer from the market place, not simply to reflect it. The Commission should not rely upon prices over which it has not exercised careful control.[47]

One Court of Appeals has viewed the Commission's reliance on contract prices as the reason for the CATCO opinion.

> [W]e perceive that most of the Commission's approach to the certification procedures, until stopped by the Supreme Court in CATCO, was subject to the [following] criticism . . .: that the Commission was permitting

[45] The Commission may, however, impose a temporary moratorium on price increases. See *United Gas Improvement Co.* v. *Callery Properties, supra* note 31. A price moratorium was imposed in the instant case, but it is not before us on appeal.

[46] The Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges. *Atlantic Refining Co.* v. *Public Service Commission, supra* note 6, at 388.

[47] See *Atlantic Refining Company* v. *Federal Power Commission, supra* note 42, at 28, n. 11, 316 F.2d at 679, n. 11.

> the initial filing prices to be fixed by the producers merely on a showing, *so far as price justification was concerned,* that they had been bargained for at arm's length, or that they were not higher than a price someone else was then paying in the area.[48]

And this court has been wary of allowing the Commission to avoid its responsibility by relying on prices negotiated in the market place.[49]

The Use of Temporary Certificates and the Policy Statement

If the Commission relies on prices over which it has never exercised control, it effectively abdicates its responsibility to protect consumers. Although prices contained in temporary certificates are not completely without Commission control, neither are they subjected to thorough consideration. According to the statute, temporary certificates are granted only "in cases of emergency" pending determination of an application for a permanent certificate. Temporaries are granted in *ex parte* proceedings "without notice or hearing."[50] No record is made, so it is impossible for a court to know on what basis the Commission granted the certificate. Accordingly, standards on review are minimal. This court has upheld a temporary certificate

[48] ***United Gas Improvement Co.* v. *Federal Power Commission, supra* note 43, at 135-36. [Emphasis in the original.] See also *United Gas Improvement Co.* v. *Federal Power Commission,* 290 F.2d 147, 148 (5th Cir.), *cert. denied sub nom. Superior Oil Co.* v. *United Gas Improvement Co.,* 366 U.S. 965 (1961).**

[49] ***Public Service Commission* v. *Federal Power Commission,* 109 U.S. App. D.C. 289, 291, 287 F.2d 143, 145 (1960), and *Public Service Commission* v. *Federal Power Commission,* 109 U.S. App. D.C. 292, 296, n. 4, 287 F.2d 146, 150, n. 4 (1960), *cert. denied sub nom. Hope Natural Gas Co.* v. *Public Service Commission,* 365 U.S. 880 (1961).**

[50] **15 U.S.C. § 717f(c) (1964).**

although we admitted that the summary nature of the proceeding precluded us from passing intelligently upon the parties' contentions.[51]

Recently, though, the FPC has attempted to make temporary certification a more considered decision. In 1960 it promulgated a Policy Statement which included guideline prices beyond which it would not certificate sales, even temporarily. In theory, the Policy Statement could justify inclusion of temporary certificates in the permanent certificate price array, since the Policy Statement could provide some degree of intelligent control over temporary prices.

In fact, however, the Policy Statement has not had a curative effect. The FPC itself seems to give the Statement very little (and very ambiguous) weight. In its first statement, the FPC said that "these price levels . . . are for the purpose of guidance and initial action by the Commission and their use will not deprive any party of substantive rights."[52] When the State of Wisconsin petitioned this court to review the Policy Statement, the FPC moved for dismissal on the ground that the Policy Statement "does not modify the procedures under which certificates are granted. . . . It denies no rights and imposes no obligations."[53] We agreed and dismissed Wisconsin's petition for review.[54] The Commission has repeatedly held

[51] *Public Service Commission* v. *Federal Power Commission,* 117 U.S. App. D.C. 195, 199, 327 F.2d 893, 897 (1964). See also *American Liberty Oil Co.* v. *Federal Power Commission,* 301 F.2d 15 (5th Cir. 1962). And see *Public Service Commission* v. *Federal Power Commission, supra* note 28, at 294, 329 F.2d at 249, in which this court characterized temporary certificates as being "without notice or hearing or mature consideration."

[52] 24 FPC 818, 819 (1960).

[53] *Wisconsin* v. *Federal Power Commission,* No. 16118 Motion to Dismiss, p. 2 (1961).

[54] *Wisconsin* v. *Federal Power Commission,* 110 U.S. App. D.C. 260, 292 F.2d 753 (1961).

that the Policy Statement does "not purport to fix the 'in-line' price."[55] And recently the Commission characterized the guideline prices as being relevant only when "no protests or petition to intervene [are] filed" in the certification proceeding.[56] In the instant case, only one Commissioner relied upon the guideline prices; two ignored them, and two felt that reliance upon the Policy Statement would be impermissible.

Further, we cannot know whether the guideline price actually controls temporary prices unless we know what the guideline price is based on. For example, it is conceivable that temporary certificates have significant influence upon the guideline price. If so, the guidelines do not control temporary prices. In any event, it is impossible to determine how the guidelines were set. The Commission listed a number of very general factors but was not specific about what the factors were or how they were considered. When asked, the FPC refused to disclose the basis for its determination.[57]

A still more persuasive reason for eliminating temporary prices from the permanent price array is the way their use may injure consumers. The effect may be a slow escalation of in-line prices: An in-line price is set; the guideline price is set somewhat higher; temporary certificates are granted at the guideline price; the new temporary certificates are used in determining a new in-line price, which will be higher than the first in-line price; the new in-line price raises the

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[55] *Amerada Petroleum Corp.,* 29 FPC 171, 172 (1963), *Union Texas Petroleum,* 29 FPC 273, 275 (1963), *Union Texas Petroleum,* 29 FPC 733, 734 (1963).

[56] 30 Fed. Reg. 4670, 4671 (1965). See also *Amerada Petroleum Corp., supra* note 55, at 172 and *Union Texas Petroleum,* 29 FPC at 275 (1963).

[57] See, *e.g.,* Nos. 7781, *et al., Sunray DX Oil Co.* v. *Federal Power Commission,* (10th Cir. Dec. 9, 1966), Op. pp. 15-19; *Amerada Petroleum Corp., supra* note 55.

guideline price; and then the spiral begins again. Although, in fact, we cannot isolate so clearly the effect of the temporaries and the guidelines, there can be no doubt that an escalation has occurred, and in a manner similar to the process described.[58] This process contradicts CATCO's admonition to hold the line in the interim period between the sale of gas and the determination of just and reasonable rates. According to CATCO, one reason why the consumer needs protection during the interim period is that the period is often long.[59] Under the present administration of the in-line price doctrine the amount of protection for the consumer decreases as the length of the interim period increases. The longer it takes to determine a just and reasonable price, the higher the in-line price becomes, and the consumers' potential refund drops accordingly.

There is a final, and completely separate, reason why temporary prices should not affect the in-line price. The first court to discuss in-line prices held that prices which

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[58] In *Texaco Seaboard,* 29 FPC 593 (1963); the Commission found the Texas Railroad District No. 3 in-line price to be 16¢ for the period preceding September 28, 1960. At the same time, the Commission set its guideline price at 17¢. 29 FPC 590 (1963). Now the Commission finds that the in-line price for District No. 3 has jumped to 17¢.

In *Hassie Hunt Trust,* 30 FPC 1438 (1963), the Commission found the District No. 2 in-line price to be 15¢ for the period preceding September 28, 1960. At the same time, the Commission set its guideline price at 16¢. 30 FPC 1435 (1963). Now the Commission finds that the in-line price for District No. 2 has jumped to 16¢.

In *Skelly Oil Co.,* 28 FPC 401 (1962), the Commission found the District No. 4 in-line price to be 15¢ for the period preceding September 28, 1960. At the same time, the Commission set its guideline price at 16¢. 28 FPC 441 (1962). Recently the Commission found that the in-line price for District No. 4 has jumped to 16¢. See *Sunray DX Oil Co.* v. *Federal Power Commission, supra* note 57.

[59] *Supra* note 6, at 389.

were suspect because they were under a cloud of court or Commission review could not be used in the permanent price array.[60] Since then almost every court,[61] including the Supreme Court,[62] has accepted the suspect price doctrine. The suspect price doctrine clearly includes temporarily certificated prices. Temporarily certificated prices may be, and often are, changed by the Commission. They are "subject to judicial review."[63] Prices that are so particularly subject to the hazard of change do "not provide a reasonably reliable basis upon which to predicate a price line."[64] And, acceptance of temporarily certificated prices has, in fact, had the effect of "creating a standard by which the questioned rates [are] judged."[65]

The producers argue, contrary to our holding, that temporarily certificated prices and contract prices must influence the in-line price. They rely on suggestions in some opinions that the line should "reflect current conditions in the industry."[66] This argument was adopted recently by the Tenth Circuit in *Sunray DX Oil Co.* v. *Federal Power Commission*[67] which held that it is permissible for the FPC to consider temporaries and contract prices.

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[60] *United Gas Improvement Co.* v. *Federal Power Commission*, *supra* note 36.

[61] See, *e.g.*, *Public Service Commission* v. *Federal Power Commission*, 109 U.S. App. D.C. 292, *supra* note 49 and *Public Service Commission* v. *Federal Power Commission*, *supra* note 28.

[62] *United Gas Improvement Co.* v. *Callery Properties*, *supra* note 31, at 227.

[63] *Ibid.*

[64] *United Gas Improvement Co.* v. *Federal Power Commission*, *supra* note 36, at 824.

[65] *Ibid.*

[66] See, *e.g.*, *ibid.*

[67] *Supra* note 57.

However, the Tenth Circuit was faced with a problem very different from ours. There, only 1.39% of the gas sold in the area was permanently certificated.[68] On this basis the court refused to apply the suspect price doctrine and approved the FPC's method of determining the in-line price. "[W]hen no appreciable volume of gas is moving under permanent certificates, the Commission has nothing upon which to base a decision as to in-lineness unless it turns to the temporaries."[69] In our case there is a substantial volume moving under permanent certificates.[70] We are not reviewing the FPC's method of determining an in-line price when there are no permanently certificated prices available for comparison.

Moreover, we cannot accept the reasoning of the Tenth Circuit's opinion as it applies to this case. Temporaries and contract prices do reflect current conditions in the industry because they reflect real dealings in the market place. This recognition, far from justifying reliance upon these prices, provides a reason for disregarding them. As we have noted, the need for in-line pricing arises because the unregulated market place cannot protect the consumer adequately. Reliance on prices over which there has been no careful regulatory control contradicts this need.

We are not suggesting, of course, that current conditions are never relevant to the FPC. In a § 4 or § 5 hearing the FPC considers current conditions in order to set a just and reasonable price. However, the courts have already rejected attempts to import standards relevant to § 4 and § 5 hearings into §7 hearings. For example, in *Callery* the producers tried to introduce economic and financial evidence, but the FPC disregarded it.[71] The Fifth Circuit re-

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[68] *Supra* note 57, at Op. p. 24.

[69] *Supra* note 57, at Op. p. 26.

[70] See, *e.g.*, H.A. 282, 284-86, 299-300; S.A. 220, 223, 226-27.

[71] See *Callery Properties* v. *Federal Power Commission*, 335 F.2d 1004, 1009 (5th Cir. 1964), for a description of the evidence.

versed the Commission. In essence the court said that this evidence was relevant to current conditions in the industry, and that these conditions were relevant to the determination of the in-line price.[72] The Supreme Court rejected this argument summarily. "To consider in this § 7 proceeding the mass of evidence relevant to the fixing of just and reasonable rates under § 5 might in practical effect render nugatory any effort to fix initial prices." [73] In the recent Tenth Circuit case the producers tried to introduce the same kind of evidence. The court responded:

> The producers seek to avoid the impact of Callery by the assertion that the proffered evidence was a streamlined presentation which could not cause any crippling delay. In our opinion, the admissibility of such evidence does not depend on any quantitative test. Relevance is determined by the substance of the offer. Although we agree with the producers that neither CATCO nor Callery establishes any specific evidentiary standards, the point is that the just and reasonable rate standards of §§ 4 and 5 do not apply to § 7 where the test is public convenience and necessity.[74]

We think this response, which is properly based on the logic of *Callery* and CATCO, is inconsistent with the same court's acceptance of temporaries and contract prices. If the courts and the FPC will not allow consideration of evidence which shows what the current conditions are, then temporaries and contract prices should not be accepted on the basis that they reflect current conditions.

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[72] *Id.* at 1013.

[73] *Supra* note 31, at 227-28. In CATCO the Supreme Court had already recognized the difference between the standards of a § 7 and a § 4 or § 5 proceeding. "[T]he Act does not require a determination of just and reasonable rates in a § 7 proceeding as it does in one under either § 4 or § 5." *Supra* note 6, at 390.

[74] *Supra* note 57, at Op. pp. 14-15.

The purpose, quite simply, of a § 7 proceeding is to protect the consumer until the FPC can determine the just and reasonable rate. This latter determination depends, in part, on current conditions in the industry. The determination of an in-line price should not depend on current conditions unless, in a particular case, there is something special about these conditions which requires the FPC to sacrifice some of the consumer's protection. For example, in a particular case, the FPC may feel that an in-line price which is too low subjects the producers to too much risk. And this risk may endanger investment in the industry. In that event the FPC would have to weigh this danger against the diminution of consumer protection. But the FPC has advanced no such reasons in this case. Here the FPC used temporarily certificated and contract prices in an automatic, arithmetical way to raise the in-line price, without attempting to justify the decrease in consumer protection.

Finally, it is argued that elimination of temporarily certificated and contract prices from the price array will cause a "price-freeze." But our proposed decision will not freeze the price of gas. If the producer is dissatisfied with the in-line price he can file a new, and higher, rate schedule under § 4 of the Act.[75] Neither will our decision permanently freeze the in-line price for an area. We presume that the in-line price will be adjusted after the Commission determines the just and reasonable price. It is true that our decision may cause the in-line price to be frozen temporarily during the interim period between sales of gas and the rate determination under § 4 or § 5 of the Act. This kind of freeze seems to be required by the logic of CATCO and in-line pricing. But we do not hold that the FPC can never raise the price line in the interim period. We hold only that the Commission has advanced no reason why an escalation is justified in this case.

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[75] See note 45, *supra*.